

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

September 18, 2001

The Capital Projects and Bond Oversight Committee met on Tuesday, September 18, 2001, at 1:00 PM, in Room 129 of the Capitol Annex, in Frankfort; Room 102 of the Business Building at Murray State University; and the Crisp Center at Paducah Community College. Representative Jodie Haydon, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jodie Haydon, Chair; Senator Robert Leeper, Vice Chairman; Senators Tom Buford and Bob Jackson; Representatives Robert Damron, Paul Marcotte, and Jim Wayne.

Guests testifying before the committee: Secretary Kevin Flanery, Glenn Mitchell, Armond Russ, Jim Abbott, Don Mullis and Tom Howard, Finance and Administration Cabinet; Warren Nash and J. R. Wilhite, Economic Development Cabinet; and Debby Milton, Kentucky Infrastructure Authority.

LRC Staff: Mary Lynn Collins, Pat Ingram, Kevin Mason, Nancy Osborne, and Shawn Bowen.

Representative Wayne made a motion to approve the minutes of the August 21, 2001 meeting as submitted. The motion was seconded by Representative Marcotte and passed by voice vote.

Chairman Haydon called on Mary Lynn Collins, Committee Staff Administrator, to review various correspondence and information items included in members' folders. Among the items she reviewed was the Kentucky Lottery Corporation's monthly financial status report for July 2001, and two items of correspondence from Western Kentucky University (WKU): a letter of invitation from WKU President Gary Ransdell to hold a committee meeting at the university in August 2002, and a letter from WKU's General Counsel relating to legal fees associated with the proposed renovation of E. A. Diddle Arena.

Representative Wayne said at the last meeting the committee requested that WKU provide information about procurement procedures to be used by the WKU Student Life Foundation for dormitory renovations. He said since that meeting President Ransdell gave him a copy of a letter sent to Steve Barger, a member of the Council on

Postsecondary Education, regarding future procurement by the Student Life Foundation. He asked that the letter be submitted as part of the committee's record.

Ms. Collins said there were three information items included in members' folders: a staff update on the proposed renovation of E. A. Diddle Arena, an update on the Budget Reserve Trust Fund, and two news articles concerning authorized projects.

Chairman Haydon called on Finance and Administration Cabinet Secretary Kevin Flanery to discuss alternatives for financing and constructing a state office building in Frankfort and to report on the state's bonded indebtedness.

Secretary Flanery introduced Glenn Mitchell, Deputy Secretary, Finance and Administration Cabinet, and Armond Russ, Commissioner, Department for Facilities Management. Secretary Flanery said his staff had recently participated in discussions with the Kentucky Employees Retirement System and the Teachers Retirement System about possibly building office space and leasing it to state government. He said the retirement systems indicated they are not interested in financing facilities for state use at this point. They are looking at other investments that will bring them a better rate of return.

Mr. Mitchell said the feasibility study on alternatives for financing and constructing a state office building in Frankfort is being done by CMW, Inc. of Lexington. The first part of the study includes design of a prototype state office building that could be reproduced to serve a variety of state government agency needs. He said they are trying to accomplish with this prototype a reasonable initial cost and reasonable life cycle cost. He said buildings constructed by the private industry and leased to the state often do not have a long life because the buildings are not as high quality. The prototype should last at least 50 years, and is designed with removable flooring, so wiring can be reconfigured as needed. Mr. Mitchell said CMW designed two buildings - one with 65,000 gross square feet and one with 127,000 gross square feet.

Mr. Mitchell said the second phase of the feasibility study, which has not been completed, will include a cost comparison of various methods of financing the prototype. Mr. Mitchell said a private owner could probably construct the same building for about 90% of the cost of a public owner because of the different regulations the state must follow. He said CMW Inc. is doing a complex financial analysis of how different providers of a state building would analyze their ability to realize a return on their investment that will be compared to government financing. He said they will develop a set of assumptions, and given those assumptions, they will determine whether a private contractor can deliver the prototype at a better price than the state.

Mr. Mitchell noted the Fantus Study (conducted in 1997 by Fantus Consulting) recommended that the amount of state-leased office space in Frankfort be reduced by

approximately one-half. That study contained a financial analysis that compared state financing and a private leasing arrangement which the Finance Cabinet staff updated, based on the prototype design. This analysis shows state financing is a much more economical option. He said if a private company built one of the prototype buildings, the estimated lease rate would be \$14-\$16 per sq. ft., which is considerably higher than the most recent lease awards. However, he noted the higher quality of the prototype.

In response to a question from Senator Jackson, Mr. Mitchell said the comparison did not take into consideration that the building is an appreciable asset. Senator Jackson urged that this be considered in the analysis.

Representative Marcotte commended the Finance Cabinet for the depth of this study. He said he was pleased to see it, and will be looking forward to seeing the second phase of the study. He expressed concerns relating to the tight real estate market in Frankfort, and encouraged the Cabinet to continue efforts to build additional office space here.

In response to a question from Representative Damron, Mr. Mitchell said the regulatory restrictions on government-built buildings include paying the prevailing wage. Representative Damron said it is very likely if the state negotiates with a private entity to build and finance a public facility, the private entity will fall under the same guidelines. He said if that was the case, it would make the proposal for the state to build/finance office space more attractive.

Representative Damron also pointed out that if the state does construct additional office space, some state leases for privately-owned office space in Frankfort would be eliminated, which would make the bidding much more competitive on future state leases. He said by constructing one or two buildings, the state would realize a cost savings on future rent that the state pays on other facilities.

Representative Damron said if the state decides to issue bonds to build its own facilities, the state could make a strong case before the bond rating agencies that these particular bonds will not negatively impact the state's budgetary or financial structure since those dollars are already being expended as lease payments. In fact, he said it is sounder financial management to replace lease payments with debt service payments. He said he thought in this case, a strong argument could be made in favor of exceeding the administration's policy to limit debt service to six percent of total revenues. Secretary Flanery agreed, and said this is something they have been discussing.

Commissioner Russ said that the state currently leases two million square feet of office space in Franklin County. The space is aging, and some is going off line. As a result, there is pressure on the remaining space which is inflating pricing. He warned that if there is not some relief, the state will be paying much higher prices for leased space.

He said the market is unable to construct a building of scale needed by agencies. He said they need the 65,000 sq. ft. and 120,000 sq. ft. buildings that can house whole departments and agencies, and if bonded financing is not available, he said he would like the authority to be able to lease, using the prototype, the type of buildings the agencies need.

Representative Damron said at one point the plan was to build future state buildings in a campus-type setting. He said from a constituent's standpoint, a campus-type setting for state office buildings is preferable, and it also facilitates the work of government when an agency is housed at one location. He asked if the state is still considering the campus-type approach to constructing buildings. Secretary Flanery said the Cabinet is in the final stages of a master plan for land use in Franklin County. That plan will consider a campus-type setting for the prototype buildings.

Representative Wayne asked if there are any creative alternatives being considered for financing construction projects. Secretary Flanery said the second phase of the feasibility study will include some financing alternatives, including a possible lease/purchase arrangement with a local government entity.

Representative Wayne said cost studies show that locating a building in a downtown location costs a lot less in the long run. He asked if this was being factored into the state's plans for new buildings. Secretary Flanery said they are following developments in Franklin County and the City of Frankfort. A review of the local planning organizations would be considered.

Senator Jackson asked how much leased space in Franklin County is coming up for renewal in the next three to five years. Mr. Jim Abbott, Director, Division of Real Properties, said approximately one-fifth of the leases will be up for renewal within the next three to five years. Mr. Abbott said all of the lease contracts have a 30-day cancellation clause.

Senator Jackson asked if it is feasible to consider building another larger office building to consolidate a lot of the state offices spread out around Franklin County. Secretary Flanery said it is feasible, and over the last several biennia, the Finance Cabinet has requested a 300,000 square foot facility to consolidate agencies now in multiple locations such as the Natural Resources and Environmental Protection Cabinet.

Secretary Flanery next discussed the state's bonded indebtedness, and introduced Mr. Don Mullis, Executive Director, Office of Financial Management. Secretary Flanery said under the policy currently used which defines debt capacity as that amount where total debt service payments represent no more than six percent of total revenues, the administration estimates that the 2000-02 budget should limit authorization to no more than \$235 million.

Senator Jackson asked Secretary Flanery for an update on Western Kentucky University's proposed renovation of Diddle Arena. Secretary Flanery said he had a meeting this morning with the Council on Postsecondary Education President Dr. Gordon Davies, WKU President Dr. Gary Ransdell, and City of Bowling Green officials. He said they are trying to make sure as this project goes forward, they meet the concerns voiced by the committee. He said the Finance Cabinet will continue to play a very pivotal oversight role in the project, and will continue to keep the committee informed. Secretary Flanery said WKU did agree today to report back to the committee when the project is ready.

Senator Jackson asked about the financial stability of the Hilltopper Athletic Foundation since under the current proposed agreement, the Foundation would be responsible for any outstanding bills if the 2002 General Assembly does not approve the renovation project. Secretary Flanery said he did not know the financial particulars about Hilltopper Athletic Foundation. He indicated they are trying to make sure that the state and the city incur no obligation to pay for any interim financing. If the General Assembly approves the project, then any outlays or any obligations that were incurred would be taken care of within the general obligation bond which is to be issued by the City of Bowling Green.

Representative Wayne complimented Secretary Flanery on how he has handled the E.A. Diddle Arena proposal. He said Secretary Flanery has provided a watchdog role along with the Attorney General's office and Dr. Davies' office. He asked if WKU plans to spend over \$400,000 before any authorization by the 2002 General Assembly. Secretary Flanery said WKU now anticipates obligating approximately \$2.3 million to the project between now and the time the General Assembly considers and approves this project, and the draft agreement would limit such obligations to \$3 million. Secretary Flanery said under the prior arrangement presented to the committee last month, WKU would be obligated to pay up to \$400,000 for costs incurred if the project is not authorized by the 2002 General Assembly. Under the current scenario, however, WKU would have no obligation to pay anything if the project is not approved. That obligation would be the total responsibility of the Hilltopper Athletic Association.

Bill Hintze, Governor's Office for Policy and Management, added that this is a state project for WKU and even if the expenditure was to exceed \$400,000 from private funds or non-state sources, that item would have to be reported to the committee once they reached the threshold. He said there are many loose ends regarding this project, but they have a clear recognition that non-state contributions to a public state-owned project must be reviewed by the committee.

In response to questions from Representative Wayne, Secretary Flanery said they will try to submit a report regarding the proposed E.A. Diddle Arena renovation before

the next meeting. He said there is still a lot of work to be done and the staff will try to finalize some of the issues. Secretary Flanery said both the City of Bowling Green and the WKU Board of Regents have approved resolutions authorizing the project to move forward. However, he said the project format, the contractual agreements, and the bond issuance have not been approved yet by the Finance and Administration Cabinet.

Senator Buford asked about legal fees WKU owes to the law firm of Wyatt, Tarrant & Combs for its services for this project. Secretary Flanery said the law firm is representing the City of Bowling Green. He said according to correspondence from WKU General Counsel to the committee, the total dollar figure quoted by Wyatt, Tarrant & Combs is \$280,000 for the entire project or \$100,000 if the project is not approved by the General Assembly. Secretary Flanery said he had asked the WKU General Counsel to clarify that the rate is an hourly rate of \$125 and not a lump sum rate. He also noted that Wyatt, Tarrant, & Combs is not serving as bond counsel.

Senator Buford asked if a design has been completed for Diddle Arena and if so, how much has the architect been paid. Secretary Flanery said an architect was hired to conduct a feasibility study as a result of a competitive process initiated by the city, the county, and the Hilltopper Athletic Foundation. He added that he did not know how much the architect was owed, and had asked WKU and the city to clarify what language in the initial procurement contract authorized the architect to do additional work beyond the feasibility study. He said he had made it clear that the design work for the renovation must be competitive bid in a procurement separate from the feasibility study procurement. In response to a further question by Senator Buford, Secretary Flanery said he would ask the city and WKU to provide additional information about legal fees and design fees incurred to date.

Mr. Abbott discussed a lease renewal report for PR-3698, Cabinet for Families and Children, in Campbell County. The lease has an annual cost of \$326,976. Senator Buford made a motion to approve lease contract PR-3698. The motion was seconded by Representative Wayne and passed by voice vote.

Mr. Abbott then discussed a new lease contract in Franklin County for the Department of Workers' Claims (PR-4557). The Department will be relocated to property owned by C. Michael Davenport. The Department is being asked to relocate because the current lessor, the Kentucky Retirement System (KRS), needs additional office space. Mr. Abbott said five offers were made and the bids ranged from \$8.50 sq. ft. to \$13.90 sq. ft. The annual cost of the lease is \$466,586.

Senator Jackson asked if the KRS identified a need for additional space in its Six-Year Capital Plan. Mr. Abbott said the KRS purchased this building within the last year, and indicated to his office last spring that they needed additional space in the building for their own staff since they have hired 80 additional staff. Senator Jackson said the

Department of Workers' Claims is being displaced on fairly short notice, which will cost the state additional money. Mr. Abbott said the new building will not be ready until April or May 2002. They have discussed with the KRS accommodations to facilitate some additional staff they are bringing on immediately.

In response to a question from Senator Jackson, Mr. Abbott said the Department of Workers' Claims must vacate the building no later than June 30, 2002.

Representative Wayne made a motion to approve lease contract PR-4557. The motion was seconded by Representative Marcotte and passed by voice vote.

Chairman Haydon then called on Mr. Don Mullis, Executive Director, and Mr. Tom Howard, Deputy Executive Director, of the Office of Financial Management, to present the agency's bond activity report. Mr. Howard first reported a new bond issue: Kentucky Economic Development Finance Authority (KEDFA) Revenue Bonds, Series 2001, for Catholic Health Initiatives (\$50,000,000). The proceeds will be used to finance capital expenditures at six acute care facilities and a service center in Kentucky. Representative Marcotte made a motion to approve the new bond issue. The motion was seconded by Representative Wayne and passed by voice vote.

Mr. Mullis then presented a revised report for State Property and Buildings Commission (SP&BC) Revenue Bonds and Revenue Refunding Bonds, Project No. 72, in an amount not to exceed \$250,000,000. Mr. Mullis said they are now proposing a structure different from the one presented to the committee last month. Mr. Mullis explained that they have added some refunding components that would allow them to pick up \$500,000 of some short maturities of various bond issues. They are also proposing to use a technique called "wrapped debt service" to push the principal repayment into the latter part of the maturity range. This would continue to be a 20-year bond issue, but it would be amortized more slowly in the first nine or ten years and more rapidly in the last 10 years. He said one reason for doing this is that the state is extremely front-loaded in its debt service payments - over 60% of debt service amortizations occur in the first 10 years of the maturity range. Mr. Mullis said the rating community looks for a more staggered and progressive amortization, more in the 25-50% range for five and ten year maturities. This bond issue is an opportune time to push some of that maturity back, and get the state more in line with the rating agencies criteria. By restructuring Project No. 72, approximately 57% of debt service amortizations will occur within 10 years.

Mr. Mullis said if the state pays its debt off more slowly, that comes with a cost. Previously, they estimated the cost to be approximately \$2 million in present value costs. However, based on current market conditions, the cost will be closer to \$3 million, although the restructuring will free up approximately \$5.5 million per year in budgeted debt service payments for the next seven or eight years. Mr. Mullis said this would

represent a limited use of this particular structuring, and he did not anticipate doing this again under the current authorization. He said the SP&BC had approved the issue as restructured.

In response to a question from Representative Wayne, Mr. Howard said rates are the lowest they have been in 20 years. He said the fact that they would be able to rebalance their portfolio at such low cost is a very attractive opportunity. He suggested the true cost of this structure depends on what is done with the \$5.5 million of annual debt service that will be freed up for the next seven or eight years.

Senator Leeper said he was not comfortable with the concept of wrapped debt service. He asked if any discussion has occurred regarding the criteria for using this option in the future. Mr. Mullis said this proposed structure is for a limited use because in the current market costs are extremely low. If the market changes next week, they may not use it. He said they are doing this in consultation with the legislative staff and in consultation with the committee, and feel that is the appropriate framework for the review of any of the alternatives they utilize in their financing. Mr. Howard added according to the bond rating agencies' criteria, the minimum is 25% maturing within five years and 50% within ten years. He said the fact that they would be moving from 32% in five years, down to 28% and from 64% in ten years down to 57% is well within the comfort guidelines of the rating agencies. He said if they go beyond that, that would raise concerns with the rating agencies. He said the levels produced with this transaction are realistic, but they do not see using wrapped debt service on a regular basis.

Representative Damron made a motion to reapprove the SP&BC bond issue. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Howard presented a follow-up report for SP&BC Revenue Bonds, Project No. 71 (\$152,860,000). Chairman Haydon said no action is required for follow-up reports.

Lastly, Mr. Howard reported three new bond issues with School Facilities Construction Commission (SFCC) debt service participation: Madison County, Rockcastle County, and Somerset Independent (Pulaski County).

Senator Buford made a motion to approve the school bond issues with SFCC debt service participation. The motion was seconded by Representative Marcotte and passed by voice vote. Representative Damron abstained from the vote, citing a potential conflict of interest.

Chairman Haydon said there was only one locally-funded school bond issue submitted to the committee for review this month, and it was for Fayette County. He said all disclosure information has been filed, and no further action on this bond issue is required.

Chairman Haydon next introduced Mr. Warren Nash, Director of the Grants Programs, and Commissioner J. R. Wilhite, Economic Development Cabinet. Mr. Nash presented an Economic Development Bond (EDB) project to benefit Toyotetsu Mid America LLC. The Cabinet is proposing to make a grant of \$100,000 to the company, through the City of Owensboro. Proceeds will allow Toyotetsu Mid America to construct a 174,000 square foot manufacturing facility on a 43-acre site. The facility will produce stamped and welded automobile parts, and the anticipated cost of the facility will be \$13,308,000. Mr. Nash said the grant will produce 150 new full-time jobs at an hourly rate of \$13.08.

Representative Marcotte made a motion to approve the EDB grant for Toyotetsu. The motion was seconded by Representative Damron and passed by voice vote.

Mr. Nash then presented another EDB project: a grant of \$500,000 to the Springfield-Washington County Economic Development Authority through the City of Springfield in Washington County. Proceeds will be used to assist in the financing of the installation of additional water, sewer, and gas lines to an industrial park, Clearview Commerce Center. The project will cost approximately \$1,572,270. Mr. Nash said the Authority will be required to create 75 new full time jobs.

Representative Damron made a motion to approve the EDB grant for the Springfield-Washington County Economic Development Authority. The motion was seconded by Representative Marcotte and passed by voice vote.

Mr. Nash then discussed four grants for the Kentucky Economic Opportunity Zone (KEOZ) Program. He said the 2000 General Assembly enacted a new tax incentive program under Senate Bill 225 known as KEOZ. The program established new tax incentives to bring business investment to economically challenged urban and rural areas. The 2000-2002 budget included an appropriation of \$2 million in bond funds for KEOZ projects. The funds will be used for the acquisition of real estate and infrastructure improvements for economic development projects located in KEOZ certified zones. Mr. Nash said there are certified zones in place for the cities of Lexington, Hopkinsville, Louisville, and Bowling Green, and in the counties of Pulaski, Laurel, Taylor, Marion and Green.

Commissioner J. R. Wilhite said the Cabinet awarded grants of \$500,000 to each of the four certified cities. He said that does not constitute the full amount of the budget required for each project, and they are working with each community to find other funding sources. Representative Damron made a motion to approve the KEOZ grants. The motion was seconded by Representative Marcotte and passed by voice vote.

Mr. Nash then discussed the Cabinet's Annual Report on the Economic Development Bond Pool (EDB) Program. Mr. Nash said there were four EDB recipients that had not complied fully with the job creation requirements set out in the EDB grant agreement. He said the Cabinet is now negotiating with the companies to either bring them into compliance or to remedy the problem as provided in the grant agreement. Chairman Haydon said no further action is required for this item.

Chairman Haydon introduced Ms. Debby Milton, Kentucky Infrastructure Authority (KIA), to present two new Fund E (Solid Waste Grant and Loan Fund) grants for the Certified Clean Counties Program. The grants will be used to clean up open dumps. Meade County received a grant of \$75,000 and Hardin County received a grant of \$72,525.

Ms. Milton then discussed an amendment to a Fund A loan to the Mountain Water District in Pike County. The original amount is being increased by \$19,068 (or 12%) for a revised loan of \$1,116,576. The amendment is necessary for the District to provide sewer service to 25 new customers on three additional streets.

Representative Marcotte made a motion to approve the two KIA Fund E grants and the Fund A loan amendment. The motion was seconded by Senator Leeper and passed by voice vote.

Chairman Haydon then asked Mr. Bill Hintze, Governor's Office for Policy and Management, and Commissioner Armond Russ to discuss the project report submitted by the Finance and Administration Cabinet.

Mr. Hintze first discussed a scope increase for the Department of Juvenile Justice Campbell Regional Juvenile Center project. He said they brought to the committee a few months ago an unbudgeted project at the center to include important elements that had to be deleted from the original facility's scope due to budgetary reasons. The unbudgeted project was authorized at \$645,000 (\$580,000 from federal funds and \$65,000 from agency funds). Mr. Hintze said the bids for this project came in over the estimate by approximately \$90,000, and the Department has restricted agency funds available to make up that difference and accept the low bid.

Representative Marcotte made a motion to approve the scope increase. The motion was seconded by Representative Damron and passed by voice vote. The revised project scope is \$735,000.

Mr. Hintze then reported a land acquisition project in Henry County for the Kentucky Department of Education Kentucky School for the Blind. An additional \$32,450 was allocated to the original grant amount of \$450,550 for a revised grant of \$483,000 from the Kentucky Heritage Land Conservation Fund to the Kentucky School

for the Blind for acquisition of the 300-acre Crowe property. This Henry County site will be one of the first public blind outdoor recreation projects in the United States. Chairman Haydon said no further action is required for land acquisition projects.

Chairman Haydon said the next committee meeting is scheduled for October 16 at 1:00 p.m. in Room 129.

Representative Damron made a motion to adjourn the meeting. The motion was seconded by Senator Leeper and passed by voice vote. The meeting adjourned at 3:00 p.m.